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ECONOMIC ANALYSIS: DETERIORATION IN EASTERN EUROPE'S
TERMS OF TRADE VIS-A-VIS THE SOVIET UNION

1. BEGIN SUMMARY: THE SOVIET UNION HAS RAISED THE PRICES
OF MANY OF ITS EXPORTS--ESPECIALLY RAW MATERIALS AND
ENERGY RESOURCES--TO THE COUNTRIES OF EASTERN EUROPE. THE
INCREASES, REFLECTING WORLDWIDE INFLATION, INDICATE THAT
THE USSR IS NO LONGER WILLING TO TOLERATE THE SIZE OF THE
GA, BETWEEN SOVIET EXPORT PRICES TO ITS PARTNERS IN THE
COUNCIL FOR MUTUAL ECONOMIC ASSISTANCE (CEMA) AND PRICES
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ON THE ;ORLD MARKET. PRICES OF SOVIET EXPORTS TO CEMA
COUNTRIES HOWEVER STILL REMAIN BELOW WORLD MARKET LEVELS.

2. PRICES OF MANY EAST EUROPEAN EXPORTS TO THE USSR HAVE

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ALSO BEEN RAISED. ON BALANCE, HOWEVER, THE RECENT CHANGES BENEFIT THE USSR AT THE EX,ENSE OF EASTERN EUROPE.

3. ENOUGH DATA HAVE BEEN RELEASED ON THE PRICE INCREASES IN SOVIET-HUNGARIAN TRADE TO INDICATE THAT HUNGARY'S TERMS OF TRADE VIS-A-VIS THE SOVIET UNION WILL DETERIORATE BY ABOUT 11 PERCENT. WE LACK SPECIFIC INFORMATION ON THE NEW PRICES IN SOVIET TRADE WITH THE OTHER CEMA MEMBERS, BUT ORDER-OF-MAGNITUDE CALCULATIONS BASED ON THE SOVIET-HUNGARIAN DATA IMPLY THAT TERMS-OF-TRADE DETERIORATION WILL BE SUBSTANTIAL FOR ALL COUNTRIES OF EASTERN EUROPE EXCEPT ROMANIA.

4. THE RATIOS OF THE LIKELY TERMS-OF-TRADE DETERIORATION FOR INDIVIDUAL EAST EUROPEAN COUNTRIES TO THE SIZE OF GNP IN THOSE COUNTRIES RANGE FROM 0.5 TO 1.0 PERCENT. THESE RATIOS ARE NOT LARGE ENOUGH TO POINT TO ABSOLUTE DECLINES IN AGGREGATE ECONOMIC ACTIVITY, BUT THEY ARE SUFFICIENTLY HIGH TO SUPPORT EXPECTATIONS OF A SIGNIFICANT ADVERSE IMPACT ON EAST EUROPEAN ECONOMIC GROWTH. END SUMMARY.

5. RESPONSE TO WORLDWIDE INFLATION: THE CURRENT INCREASES IN PRICES OF GOODS TRADED AMONG THE SOVIET UNION AND THE COUNTRIES OF EASTERN EUROPE ARE A DEPARTURE FROM CUSTOMARY PROCEDURES, WHICH WOULD HAVE LEFT PRICES UNCHANGED UNTIL THE INAUGURATION OF THE NEW FIVE-YEAR PLANS IN 1976.

6. THE USSR INITIATED THE AHEAD-OF-SCHEDULE PRICE RISES, CLEARLY RESPONDING--IN A MANNER THAT WILL ADVERSELY AFFECT ITS EAST EUROPEAN TRADE PARTNERS--TO THE WORLDWIDE INFLA-TION OF RECENT YEARS. SPECIFICALLY, THE USSR ACTED BECAUSE IT WAS NO LONGER WILLING TO TOLERATE THE SIZE OF THE DISPARITY BETWEEN SOVIET EXPORT PRICES TO CEMA COUN-TRIES AND PRICES ON THE WORLD MARKET. OIL PRICES, AND PRICES OF OTHER COMMODITIES AS WELL, CHARGED BY THE USSR TO OTHER CEMA MEMBERS WILL STILL REMAIN, HOWEVER, BELOW
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CURRENT WORLD MARKET PRICES.

7. THE SOVIETS HAVE RAISED THE PRICE OF OIL MORE STEEPLY (137 PERCENT) THAN THAT OF ANY OTHER EXPORT COMMODITY; NONETHELESS, THE SOVIET PRICE RISES ARE QUITE PERVASIVE. ALTHOUGH PRICES OF SOME EAST EUROPEAN EXPORTS TO THE USSR ARE ALSO BEING RAISED, THE USSR WILL, ON BALANCE, BENEFIT AT THE EXPENSE OF EASTERN EUROPE.

8. DATA ON SOVIET-HUNGARIAN PRICE CHANGES: HOW MUCH WILL THE USSR'S TERMS OF TRADE IMPROVE? A GENERAL ANSWER IS NOT POSSIBLE AT THIS TIME, BUT ENOUGH DATA HAVE BEEN

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RELEASED ON THE PRICE ADJUSTMENTS ARRANGED EARLIER THIS

YEAR BETWEEN HUNGARY AND THE USSR TO PERMIT A FAIRLY SPECIFIC ESTIMATE OF THEIR IMPACT ON THE BILATERAL TERMS OF TRADE FOR THESE TWO COUNTRIES. IN ADDITION, THE DATA ON SOVIET-HUNGARIAN PRICE CHANGES CAN BE USED TO MAKE SOME TENTATIVE, ORDER-OF-MAGNITUDE CALCULATIONS FOR THE OTHER COUNTRIES OF EASTERN EUROPE.

9. OUR ESTIMATE FOR THE USSR AND HUNGARY SHOWS THAT THE CHANGE IN THE TERMS OF TRADE WILL BE SUBSTANTIALLY TO HUNGARY'S DISADVANTAGE. IT APPEARS THAT PRICES OF HUNGARIAN EXPORTS TO THE USSR WILL RISE BY SLIGHTLY MORE THAN 15 PERCENT, ON THE AVERAGE, WHILE PRICES OF HUNGARY'S IMPORTS FROM THE SOVIET UNION WILL RISE BY ALMOST DOUBLE THIS RATE. THIS REPRESENTS A DETERIORATION IN HUNGARY'S TERMS OF TRADE VIS-A-VIS THE USSR OF ABOUT 11 PERCENT. (NOTE: TO MITIGATE THIS ADVERSE TERMS-OF-TRADE EFFECT, THE SOVIETS HAVE INDICATED THEIR INTENTION TO MAKE CERTAIN CONCESSIONS TO HUNGARY. THESE INCLUDE EXPANDING SHIPMENTS OF CERTAIN COMMODITIES, INCLUDING OIL, ABOVE INITIALLY PLANNED LEVELS AND EXTENDING LONG-TERM CREDITS.)

10. APPLICATION TO OTHER COUNTRIES: APPLICATION OF THE REPORTED CHANGES IN PRICES IN SOVIET-HUNGARIAN TRADE TO OTHER SOVIET-EAST EUROPEAN TRADE YIELDS ESTIMATES OF

DETERIORATION IN TERMS OF TRADE OF ABOUT 20 PERCENT FOR CZECHOSLOVAKIA; 16 PERCENT FOR POLAND; 12 PERCENT FOR
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EAST GERMANY; 7 PERCENT FOR BULGARIA; AND 2 PERCENT FOR ROMANIA. IT MUST BE STRESSED THAT THESE ESTIMATES MAY BE QUITE IMPRECISE, FAR MORE SO THAN THE ALREADY ADMITIEDLY ROUGH ESTIMATES FOR HUNGARY, BECAUSE:

(A)--THE PRICE CHANGES IN THE USSR'S TRADE WITH OTHER CEMA COUNTRIES MAY NOT BE THE SAME AS IN SOVIET-HUNGARIAN TRADE; AND

(B)--EVEN IF PRICE CHANGES FOR INDIVIDUAL COMMODITIES ARE THE SAME, THE SOVIET-'UNGARIAN PRICE INFORMATION IS NOT STRICTLY APPLICABLE TO OTHER COUNTRIES' TRADE STATISTICS.

11. WITH REGARD TO (B), MOST OF THE ANNOUNCED PRICE INCREASES REFER TO BROAD COMMODITY GROUPS. CONSEQUENTLY, AN AVERAGE PRICE CHANGE FOR A GIVEN COMMODITY GROUP IN ONE COUNTRY WOULD NOT BE THE SAME FOR THAT COMMODITY GROUP IN ANOTHER COUNTRY BECAUSE OF VARIATION IN COMPOSITION OF THE TWO GROUPS.

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12. NONETHELESS, THE COMPOSITION OF THE HIGHLY AGGREGATED COMMODITY GROUPS FOR WHICH PRICE CHANGES FOR HUNGARY HAVE BEEN REPORTED IS BELIEVED TO BE SUFFICIENTLY SIMILAR FOR ALL EAST EUROPEAN COUNTRIES TO MAKE CALCULATED CHANGES IN THE TERMS OF TRADE FOR THESE OTHER COUNTRIES AT LEAST INDICATIVE.

13. IMPACT OF TERMS-OF-TRADE CHANGES: THE DECLINES IN THE TERMS OF TRADE LISTED ABOVE WOULD REPRESENT A SUBSTANTIAL REAL COST TO THE ECONOMIES OF ALL THE COUNTRIES EXCEPT ROMANIA. TO MAINTAIN A GIVEN VOLUME OF TRADE WITH THE USSR, EASTERN EUROPE WILL PROBABLY BE FORCED TO DIVERT EXPORTS FROM THE WEST TO THE USSR AND SACRIFICE MUCH-NEEDED IMPORTS FROM THE WEST. AS A RESULT, ECONOMIC GROWTH IN EASTERN EUROPE IS LIKELY TO BE SLOWED, AND STANDARDS OF LIVING WILL BE AFFECTED.

14. THE IMPACT OF THE EXPECTED TERMS-OF-TRADE CHANGES CAN BE EXPRESSED QUANTITATIVELY BY RELATING THEM TO THE SIZE OF GROSS NATIONAL PRODUCT IN THE COUNTRIES CONCERNED.
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FOR HUNGARY, WHERE TRADE WITH THE USSR IS ABOUT ONE-THIRD OF HUNGARY'S TOTAL TRADE AND WHERE TOTAL TRADE EQUALS NEARLY ONE-FOURTH OF THE GNP, THE TERMS-OF-TRADE EFFECT OF THE RECENT PRICE CHANGES WOULD BE EQUIVALENT TO ALMOST 1 PERCENT OF GNP. ALTHOUGH NOT LARGE ENOUGH TO POINT TO AN ABSOLUTE DECLINE IN ECONOMIC ACTIVITY, THIS NEGATIVE TERMS-OF-TRADE EFFECT, AS NOTED ABOVE, COULD PERCEPTIBLY INHIBIT HUNGARY'S GROWTH AND DEVELOPMENT.

15. FOR ROMANIA, THE TERMS-OF-TRADE EFFECTS IN RELATION TO GNP WOULD BE INCONSEQUENTIAL, LARGELY BECAUSE ROMANIA (1) IS MORE SELF-SUFFICIENT THAN THE OTHER COUNTRIES OF EAST EUROPE AND (2) IMPORTS NO OIL FROM THE USSR.

16. FOR THE OTHER FOUR COUNTRIES, AS FOR HUNGARY, THE EFFECTS WOULD BE FAR FROM NEGLIGIBLE. THE RATIO OF THE ESTIMATED DETERIORATION IN THE TERMS OF TRADE VIS-A-VIS THE SOVIET UNION TO THE SIZE OF GNP RANGES FROM ABOUT 0.5 PERCENT FOR POLAND TO ABOUT 1.0 PERCENT FOR CZECHOSLOVAKIA, WITH THE VALUES FOR BULGARIA AND EAST GERMANY LYING ROUGHLY MIDWAY BETWEEN. (NOTE: THESE ESTIMATED RATIOS OF DETERIORATION IN THE TERMS OF TRADE TO GNP ARE NOT FORECASTS OF DECREASES IN RATES OF GNP GROWTH. THEY ARE INTENDED ONLY TO INDICATE THAT THE NEGATIVE IMPACT ON GROWTH MAY BE SIZABLE.)

(A)--THE MAIN REASON THAT THE TERMS-OF-TRADE DETERIORATION/GNP RATIO IS GREATEST FOR CZECHOSLOVAKIA IS THAT OIL

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ACCOUNTS FOR A RELATIVELY LARGE PERCENTAGE OF CZECHOSLO-
VAKIA'S IMPORTS FROM THE USSR--17 PERCENT IN 1973, THE
HIGHEST FOR ANY EAST EUROPEAN COUNTRY.

(B)--IN BULGARIA'S CASE, THE EFFECT OF THE RECENT CHANGES
ON THEIR TERMS OF TRADE IS EXPECTED TO BE RELATIVELY
MILD. ONE REASON IS THAT MANUFACTURED GOODS, FOR WHICH
THE SOVIETS ARE INCREASING PRICES ONLY SLIGHTLY, ACCOUNT
FOR A RELATIVELY LARGE SHARE OF BULGARIAN IMPORTS FROM
THE USSR. ANOTHER IS THAT AGRICULTURAL COMMODITIES, FOR
WHICH THE SOVIETS HAVE AGREED (AT LEAST WITH HUNGARY) TO
PAY SUBSTANTIALLY HIGHER PRICES, ACCOUNT FOR A RELATIVELY
LARGE PROPORTION OF BULGARIAN EXPORTS TO THE USSR. HOW-
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EVER, TRADE MAKES UP A SIZABLE PROPORTION OF THE BULGARIAN
GNP--MORE THAN 20 PERCENT--AND TRADE WITH THE USSR AMOUNTS
TO ABOUT HALF OF BULGARIA'S TOTAL TRADE. THUS EVEN THE
MODEST TERMS-OF-TRADE DETERIORATION FORESEEN FOR BULGARIA
IS EQUIVALENT TO A SIGNIFICANT FRACTION--RELATIVELY
SPEAKING--OF ITS GNP.

(C)--EAST GERMAN TRADE WITH THE USSR AS A PERCENTAGE OF
THE GDR'S GNP IS ONLY A LITTLE MORE THAN 5 PERCENT--ABOUT
HALF THE CORRESPONDING SHARE FOR BULGARIA. BUT BECAUSE
THE DETERIORATION IN EAST GERMANY'S TERMS OF TRADE WITH
THE SOVIET UNION IS LIKELY TO BE COMPARATIVELY LARGE--
ABOUT THE SAME AS FOR HUNGARY--THE TERMS-OF-TRADE
DETERIORATION/GNP RATIO IS ALMOST THE SAME FOR EAST
GERMANY AS FOR BULGARIA.

(D)--THE LOW VALUE OF THE RATIO FOR POLAND IS LARGELY A
REFLECTION OF THE FACT THAT POLAND'S TRADE WITH THE
USSR EQUALS ONLY SLIGHTLY MORE THAN 3 PERCENT OF POLISH
GNP. POLAND'S AMPLE COAL RESOURCES, MOREOVER, MAY ALLOW
A SIGNIFICANT REDUCTION IN THE SUBSTANTIAL QUANTITIES OF
OIL POLAND NOW IMPORTS FROM THE USSR. MORE GENERALLY,
THEY MAY ENABLE POLAND TO AVOID OR MITIGATE THE SERIOUS
BALANCE-OF-PAYMENTS PROBLEMS FACED BY OTHER COUNTRIES IN
EAST EUROPE. INGERSOLL

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